Independent Insurance Agents & Brokers of America, Inc.

STATEMENT OF STEVEN J. SPIRO
ON BEHALF OF THE
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA

BEFORE THE

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY AND SUBCOMMITTEE ON CAPITAL MARKETS, GOVERNMENT SPONSORED ENTERPRISES, AND INSURANCE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

September 6, 2007

Good afternoon Chairwoman Waters, Chairman Kanjorski, Ranking Member Biggert, Ranking Member Pryce and Members of the Committee. My name is Steven J. Spiro, CLU, ChFC, and I am pleased to be here today on behalf of the Independent Insurance Agents & Brokers of America (IIABA) to provide my association's perspective on efforts to reform how our nation insures against natural disasters. I am currently serving on the Government Affairs Committee of IIABA. I am also President of Spiro Risk Management, Inc., an independent insurance agency based in Valley Stream, NY which offers a broad array of insurance products to consumers and commercial clients in New York and approximately 30 other states.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, and we represent a nationwide network of more than 300,000 agents, brokers, and employees. IIABA represents independent insurance agents and brokers who present consumers with a choice of policy options from a variety of different insurance companies. These small, medium, and large businesses offer all lines of insurance – property, casualty, life, health, employee benefit plans, and retirement products. It is from this unique vantage point that we understand the capabilities and challenges of the insurance market when it comes to insuring against catastrophic risks.

Background

Whether it is the possibility of earthquakes on the West Coast or along the New Madrid Fault or threats posed by hurricanes, just about every corner of the United States is subject to the effects of a devastating natural catastrophe. Just when Hurricane Andrew was starting to pass from our collective memory, Hurricane Katrina and the other storms of 2004 and 2005 reminded us, with devastating effect, of the deadly and sweeping impact that such catastrophes can impose on a society and economy. Although Katrina was an unprecedented event in many ways, the reality is that similar and even more powerful storms will inevitably strike the Atlantic and Gulf Coasts.

This unfortunate and regrettable certainty has created what amounts to a property insurance crisis in some parts of the country, but it also affects nearly every other coastal state to some degree. I have seen the effects firsthand.

By many measures, the insurance industry is a highly competitive one. There are multiple distribution channels, and purchasers in most markets can typically buy coverage from many different direct, captive, or independent agent options. Coastal regions of this country, however, do not have a vibrant or competitive homeowners' insurance marketplace today, and the commercial marketplace is increasingly facing the same challenges. For example, a number of major companies are no longer writing new homeowners' policies on Long Island, New York. Meanwhile, the commercial marketplace is now seeing insurance policies with separate windstorm deductibles as well as new limitations on business interruption coverage, with one company recently instituting a $500,000 limit on such coverage.

Like independent agencies nationwide, I represent and have the ability to provide my customers with insurance policies from many different companies. My agency sells a wide variety of insurance policies – from personal lines products such as auto and homeowners insurance to commercial lines insurance for businesses, and from life insurance to employee benefits – and, overall, we represent over 10 different companies.

Unfortunately, there are only a handful of insurers that are able or willing to provide catastrophe coverage in my community, and much of the Eastern seaboard faces similar difficulties. Consumers today find it incredibly difficult and in many cases impossible to secure affordable insurance coverage for their homes and businesses. As an independent agent, I cannot serve my clients if I do not have insurance company partners willing to provide coverage, and that is the challenge I face today.

In order to fully appreciate this crisis, I believe it can be helpful to look at a few of the many root causes. Consider the following:

- Seven of the nine costliest hurricanes in our nation's history occurred in 2004 and 2005, and experts expect this trend to continue. While we may have received a slight respite in 2006, respected meteorologists believe the frequency and intensity of hurricanes will continue to grow over the next 15 to 20 years.

- Just three weeks ago, Hurricane Dean, the first Category 5 storm to make landfall in the Atlantic Basin since Hurricane Andrew, provided a vivid reminder of what we are confronting. In its revised 2007 hurricane outlook (issued August 9), the National Oceanic and Atmospheric Administration (NOAA) predicted an above-normal season with a likely range of 13-16 named storms, 7-9 hurricanes, 3-5 of which will be major.

- There has been unprecedented population growth and significant development in coastal and disaster-prone areas in recent decades, and total property exposures have increased dramatically. The explosive growth and concentration in these areas increases Total Insured Values and Probable Maximum Loss from hurricanes, and results in larger human and economic losses when disaster strikes. According to AIR Worldwide, a leading risk modeling and technology firm, in 2004 the value of insured coastal properties in the 18 East Coast and Gulf states exposed to hurricanes totaled $6.9 trillion, or 16 percent of insurers' total exposure to loss in the United States. Not unlike other disaster-prone areas, AIR also estimates that property values in coastal areas of the United States have doubled over the last decade.

- Wall Street firms and agencies that rate insurer financial stability have changed their evaluations and more heavily consider the effects of Probable Maximum Loss and Total Insured Value on the financial strength of insurers. This reality is forcing insurers to reduce catastrophe exposures.

- Insurance companies purchase reinsurance to help manage their catastrophe exposures, and reinsurers have increased the premiums they charge insurers to cover catastrophe claims. However, the prices and terms of property insurance offered by insurers remain highly regulated, and insurance companies are unable to pass along those costs. This reality has further decreased the amount of catastrophe risk insurers seem to be willing to accept.

National Problem

I would particularly like to stress that this issue is not simply a Gulf Coast problem – it is a national problem. Nearly all Americans live in an area that is susceptible to natural disasters, and, without a comprehensive national catastrophe plan, taxpayers across the country will continue to bear the financial burden of helping to rebuild communities hit by catastrophic events.

Hurricanes may be the most well-known and regularly occurring disasters, but they are only one of the many catastrophic risks our nation faces. According to the Insurance Information Institute, tornadoes, earthquakes, mudslides, blizzards, and other catastrophes combined have accounted for over one-half of the U.S. catastrophe losses in the last 20 years. Earthquakes are a particularly powerful threat. Neither the Loma Prieta nor Northridge Earthquakes could be categorized as the "Big One," yet these events of the last twenty years combined to cause more than 120 deaths and 10,000 injuries and resulted in over $50 billion in property damage. In the Mississippi Valley, the often-overlooked New Madrid Fault was the scene of several magnitude 8 earthquakes nearly 200 years ago, and scientists estimate that there is a 90% probability that a magnitude 6 to 7 earthquake (or greater) will indeed occur within the next 50 years. If similar disasters occurred in California or in the Midwest today, they could easily result in well over $100 billion in losses and countless casualties.

The same marketplace challenges that have affected coastal areas are now beginning to occur in earthquake and other catastrophe-prone areas. Along the New Madrid Fault line, for example, insurers are beginning to react to the exposures and risks they face. In recent weeks, both a large national and a regional company have announced their intentions to completely withdraw over time from the residential and commercial earthquake market in a multi-state region along the fault line. The regional company is the largest regional writer of homeowners' insurance coverage for independent agents in these earthquake areas, and as many as 70,000 customers could be affected by their decision alone. These latest developments are further evidence of the increasing national scope of this problem.

States across the country have admirably and proactively attempted to increase insurance capacity and decrease the risks posed by and the costs created by catastrophic events. State governments have attempted to stabilize insurance markets by implementing a variety of policy options – such as creating residual markets, catastrophe funds, and state-sponsored insurers and establishing building codes – but these efforts fail to adequately address massive natural disasters and leave our country unprepared for an especially severe hurricane or powerful earthquake. The plain truth is that some natural disasters will overwhelm the modest state-specific measures that have been implemented, and only a program that is national in scope can generate enough capacity to cover the increasingly devastating events that we have witnessed in recent years.

In order to effectively prepare for and insure against natural disasters, our country needs a national catastrophe plan, and such a program can only be established by Congress. Put simply, insuring against natural disasters is a national problem that requires a national solution. Despite our longstanding position that the insurance market is best served by limited federal involvement, we believe that a federal solution to the issue of natural catastrophe insurance is necessary to help provide capacity and fill a void that the private market cannot and will not service. However, it is important that the day-to-day regulation of insurance remain at the state level, where state insurance departments are best equipped to serve the special needs of local consumers in local markets. As such, given the absence of affordable coverage and the exposure that both consumers and taxpayers face, we believe that there is a very limited and appropriate role for the federal government, and we are open to supporting proposals that increase insurance availability and affordability in catastrophe-prone areas.

IIABA is not alone in calling on Congress to act, and an increasing number of state and local officials are coming to the conclusion that a comprehensive national solution is necessary. In February of this year, the bipartisan Southern Governors Association adopted a resolution urging Congress to create a "reasonably priced national reinsurance program supported by actuarially sound premiums." More recently, the U.S. Conference of Mayors adopted a similar resolution supporting the establishment of a national disaster plan and financial backstop. Copies of both statements are included at the end of my written testimony.

IIABA is comprised of thousands of small businesses and as such, we have always preferred market-driven solutions to problems and are suspect of new government programs. In short, we do not adopt a position like this lightly. We do so only because we see no other available course of action to resolve this availability crisis.

IIABA Perspective on the Homeowners Defense Act of 2007

On behalf of IIABA, I first would like to thank Representatives Ron Klein and Tim Mahoney for their efforts to address this natural disaster crisis. IIABA is extremely grateful for your work on this issue and for the opportunity to share its views on what we feel is a matter of critical importance.

Our members approach the issue of natural disaster insurance from a very simple perspective: we are here to serve consumers' needs, whether it is helping them secure coverage to protect their families, their homes, and their businesses prior to an event, or assisting consumers after an event to ensure that claims are paid quickly and fully. As the intermediaries between consumers and their insurers, our members cannot and will not walk away from consumer needs as long as they demand coverage for these risks. We strongly believe our industry must come together with policymakers to find a common solution that will encourage participation in at-risk markets.

In short, we welcome all proposals and support any and all <u>reasonable</u> ideas and plans that lead us to a healthy and competitive insurance marketplace in which consumers have choices and companies are vying for their business.

While IIABA is not yet ready to formally endorse the Homeowners Defense Act of 2007 at this time, we do believe it provides a number of provisions that could have a positive impact on the availability and affordability of natural disaster insurance. There are, however, important questions associated with these provisions that must be answered.

The creation of a National Catastrophe Risk Consortium would create an organization that states can voluntarily join for the purposes of transferring catastrophe risk. The risk transfer would be achieved through the issuance of risk-linked securities or through reinsurance contracts. The goal of the consortium seems to be to offer both states and private market participants an opportunity to benefit from a pooling of catastrophic risk diversified by type of peril and geographic region.

If a number of states elect to participate in this Consortium, and if the private market determines that the risk-linked securities are an attractive investment, there is the possibility that the Consortium could offer reinsurance contracts to private participants at a lower cost than is currently available. However, IIABA does have concerns that some states that may not consider themselves to be high-risk may decline to participate in the Consortium, which would diminish the diversity of the risk-linked securities and negatively impact their value to potential buyers.

The creation of a National Homeowners' Insurance Stabilization Program, meanwhile, would potentially provide for a mechanism for liquidity loans and catastrophic loans for state and regional reinsurance programs, which could provide for a level of stability for such programs that is absent at this time. The loans would come in three distinct categories, Liquidity Loans, Catastrophic Loans, and Catastrophic Loans to States without Qualified Reinsurance Programs. Perhaps most encouraging about this proposal is that it seems to offer an incentive for more states to adopt their own reinsurance CAT programs in order to be considered "qualified programs," which states would have to have in order to receive the catastrophic loans after an initial 5 year transition period. However, it may be useful for the Committee to consider adding increased incentives for the speedy creation of state CAT qualified programs, as currently the only incentive seems to be a lower interest rate on the catastrophic loan. IIABA also feels that assistance from the federal government should be limited, if at all possible, to reinsurance to help the private market participants and not to direct state insurers of last resort. We encourage this Committee to make sure that this provision achieves that objective. Finally, while the provision requires "qualified" states to comply with mitigation and building code standards established by the Secretary of the Treasury, we believe that proper mitigation and building code standards are a key piece of solving this crisis and that the Committee may want to consider providing more direction in this area.

In short, IIABA believes that the Homeowners' Defense Act of 2007 deserves serious consideration and we are hopeful that, should the issues mentioned above be resolved, these proposals could be a part of a comprehensive solution to the problem of natural catastrophe insurance. Of course, the key to the success of any solution is how the private market will react and whether it will result in increased coverage.

Other Solutions

The strength of the Homeowners' Defense Act of 2007 lies in its attempt to have a plan in place to encourage greater availability of reinsurance for the private markets (through the Consortium) <u>before</u> a storm hits as well as its attempt to have a line of stability available to state catastrophe reinsurance funds in the event of liquidity problems after a catastrophic disaster. These goals are consistent with the Big "I's" long-standing belief that the best solution is for a program to be in place before the events happen – to have a clear, well-structured mechanism that encourages the private sector to handle as much of the risk as possible, and only trigger federal involvement as a last resort upon private marketplace failure. We believe that it is important to have such a structure in place to protect both consumers and taxpayers living in all areas across the country – especially when history has proven that more tax dollars are going to be spent on disaster assistance without such a structure to encourage the private sector to take on additional risk.

It is with these sentiments that we also applaud other legislative proposals pending in Congress. Specifically, we support H.R. 330, the Homeowners' Insurance Availability Act, sponsored by Rep. Ginny Brown-Waite (R-FL). This legislation would allow private insurers to purchase, at auction, reinsurance contracts directly from the U.S. Treasury to cover natural disasters that are equal to or greater than a one-in-100-year event. We believe this is a strong proposal because it will encourage more companies to enter at-risk markets, thus increasing availability and market stability, while limiting federal involvement to only the most devastating catastrophes.

IIABA is also looking beyond federal reinsurance proposals to other possible solutions, and in that vein we are encouraged by the introduction of H.R. 164, the Policyholder Disaster Protection Act, introduced by Rep. Bobby Jindal (R-LA). This bill would permit insurers to create tax-free reserve funds for natural disaster claims. We support the goal of this legislation, which is to build up insurance capacity in at-risk markets.

Congressional Attention Is Needed

Achieving a consensus within the insurance market for a solution to this growing problem has proven elusive, which has complicated public and private efforts to address this issue. However, Members such as Representatives Klein and Mahoney have made a concerted and responsible effort to achieve the difficult to reach consensus, and we applaud them for their efforts.

We thank this Committee and the Members of Congress mentioned above for their leadership on these issues, and we look forward to continuing to work with this Committee, Representatives Klein and Mahoney, and other leaders on this issue such as Representatives Brown-Waite and Jindal on the Homeowners' Defense Act of 2007 and other legislative proposals.

In conclusion, we commend you for convening today's hearing, and we hope that the Committee will continue its thorough examination of legislative solutions for the catastrophe insurance availability crisis.

The Big "I" is committed to an open dialogue with all interested parties in the public and private sectors to address these important issues that consumers face. We stand ready to assist your efforts in any way we can.

SOUTHERN GOVERNORS' ASSOCIATION

RESOLUTION

Expressing the sense of the Southern Governors' Association that Congress should adopt legislation to create a national reinsurance plan in order to provide for the availability of reasonably priced property and casualty insurance from private markets to homeowners throughout the nation.

Whereas, every state is vulnerable to natural disasters including hurricanes, tornadoes, flooding, earthquakes, blizzards, crop loss and wildfires;

Whereas, there is an increase in the incidence of major catastrophes and their increasingly costly nature;

Whereas, there have been significant insurance and reinsurance shortages, resulting in dramatic rate increases for consumers and businesses, and the unavailability of catastrophe insurance;

Whereas, Hurricanes Katrina, Rita, and Wilma, which struck the United States in 2005, caused over $200 billion in total economic losses, including insured and uninsured losses;

Whereas, the United States federal government has provided and will continue to provide billions of dollars and resources to help our nation recover from catastrophes, including hurricanes, tornadoes, earthquakes, blizzards and other disasters, at huge costs to American taxpayers;

Whereas, the United States federal government has a critical interest in ensuring appropriate and fiscally responsible risk management and pre-planning for catastrophes through measures such as mitigation and improved building codes;

Whereas, no action has been taken on the multiple proposals that have been introduced in the United States Congress over the past decade to address catastrophic risk insurance, including the creation of a national catastrophic reinsurance fund and the revision of the Federal tax code to allow insurers to use tax-deferred catastrophe funds;

Now, therefore, be it resolved,

That it is the sense of the Southern Governors' Association that:

The United States Congress should adopt legislation to create a reasonably priced national reinsurance program supported by actuarially sound premiums to provide relief to American homeowners and lower insurance premiums.

Time limited (effective Winter Meeting 2007 through Winter Business Meeting 2009)

Celebrating 75 Years

CREATING A COMPREHENSIVE INTEGRATED NATIONAL CATASTROPHE FUND

Resolution Adopted June 2007

WHEREAS, every U.S. city plays a vital front line role in preparing and protecting their residents from the ravages of natural catastrophic events;

WHEREAS, every state is vulnerable to natural catastrophes including hurricanes, tornadoes, floods, earthquakes, blizzards, and wildfires;

WHEREAS, there is an increase in the incidence of major natural catastrophes and their increasingly costly nature;

WHEREAS, there have been significant contraction in insurance availability and significant increase in costs for consumers;

WHEREAS, Hurricanes Katrina, Rita, and Wilma, which struck the United States in 2005, caused well over $200 billion in total economic losses, including both insured and uninsured losses;

WHEREAS, the United States federal government has provided and will continue to provide billions of after-event appropriated dollars and resources to help our nation recover from catastrophes, including hurricanes, tornadoes, earthquakes, blizzards and other disasters, at huge cost to all American taxpayers;

WHEREAS, the United States federal government has a critical interest in ensuring appropriate and fiscally responsible risk management and pre-planning for catastrophes through measures such as loss prevention and mitigation, improved public education and effective emergency management services;

WHEREAS, the U.S. Congress has had under consideration, but taken no action on multiple proposals over the past decade to address natural catastrophic risk insurance, including the creation of a national catastrophe financial backstop program and revision of the Federal tax code to allow insurers to build tax-deferred catastrophe funds;

NOW, THEREFORE, BE IT RESOLVED, That The United States Conference of Mayors strongly urges Congress to adopt legislation creating a comprehensive, integrated national catastrophe plan (which includes the participation of states)to better prepare and protect American homeowners from inevitable, large-scale natural catastrophes that includes a financial backstop supported by actuarially sound premiums to improve the availability of reasonably priced property and casualty insurance from private markets to homeowners throughout the nation.